

General Information Letter: A Subchapter S corporation may carry back an Illinois net loss to offset net income in a year in which it was taxed as a Subchapter C corporation.

October 9, 1998

Dear:

This is in response to your letter dated October 5, 1998, in which you request a letter ruling. The nature of your letter and the information you have provided require that we respond with a General Information Letter which is designed to provide general information, is not a statement of Department policy and is not binding on the Department. See 86 Ill. Adm. Code 1200.120(b) and (c), enclosed.

In your letter you have stated the following:

The purpose of this letter is to request guidance regarding a specific fact pattern as set forth below. The situation involves a net operating loss incurred by an S corporation who wishes to carry the loss back pursuant to Internal Revenue Code Sec. 172(b)(1)(A)(as in effect before passage of P.L. 105-34) and IITA Sec. 207[35 ILCS 5/207].

The taxpayer is an S Corporation who was incorporated on August xx, 19xx under the laws of the state of Illinois. The taxpayer's trade or business involves short-term rentals of pediatric medical equipment to patients. The business has been conducted entirely within the state of Illinois. The taxpayer elected S Corporation status effective April 1, 1995, which was approved by the Internal Revenue Service. Prior to adoption of a calendar year end, the taxpayer utilized a March 31 fiscal year end. The taxable years and status of the taxpayer involved are as follows:

<u>Tax Year</u>	<u>Net Income (Loss)</u>	<u>Corporate Status</u>
03/31/95	\$ xx,xxx	C Corporation
12/31/95	(xxx,xxx)	S Corporation
12/31/96	xxx,xxx	S Corporation
12/31/97	(xx,xxx)	S Corporation

The election to forego the carryback of the 12/31/95 net operating loss and to carry such loss forward only was properly made under Internal Revenue Code Sec. 172(b)(3)(C). Such loss was fully utilized in tax year 1996. Also please note that tax year 1997 is the final return for this taxpayer because the taxpayer has discontinued operations and ceased business.

The issue for which we request guidance involves the December 31, 1997 net operating loss of \$xx,xxx. The taxpayer desires to carry back this net operating loss to the third carryback tax year of March 31, 1995 pursuant to the above-cited tax law, notwithstanding that the loss was incurred as an S Corporation and the third carryback year is a C Corporation. We have made general inquiry regarding this type of fact pattern and have been verbally informed that the Illinois

Department of Revenue has addressed this issue. However, we cannot find any written guidance on the subject.

Assuming that the S Corporation loss can be carried back and applied against C Corporation income, we would further assume that the carryback claim would be filed on Form IL-1120-X and Schedule NLD as opposed to Form IL-843.

We respectfully request your opinion on the permissibility of carryback of the net operating loss from an S Corporation year to a C Corporation year and which form and/or supporting documentation is required. We understand that your response would be in the form of a general letter regarding specific topics and that general information letters are not binding on the Department.

Response

A corporation that has executed a valid election under IRC §1362, choosing to be treated as an S-Corporation, is not subject to income tax at the corporate level under federal law. However, under the Illinois Income Tax Act (IITA) an S-Corporation is subject to the Personal Property Tax Replacement Tax, with income measured under 35 ILCS 5/203 and 5/304.

As a result of the Illinois corporate level tax, an S-Corporation may experience net operating loss under Illinois law. Under federal law, all losses are passed through to individual shareholders. Since there are no net operating losses at the corporate level under federal law, there are no losses to be carried either back or forward under the provisions of IRC §172. This intuitive result is codified in IRC §1371. You mention that the taxpayer has carried forward losses from the short year ending on 12/31/95, an S-Corporation year, to the year ending on 12/31/96, another S-Corporation year. Given the prohibition of IRC §1371, it is presumed that the carryover you mention was for state tax purposes or was carried out at the shareholder level for federal purposes.

Since there is an entity-level S-Corporation tax under state law, the potential for net operating loss is also recognized. IITA Section 207 provides that net operating loss carryback and carryover be measured in the manner allowed in Section 172 of the Internal Revenue Code. Section 100.2330 of Illinois Income Tax Rules further delineates state treatment of net operating loss. Section 100.2330(c) of the Rules declares that an Illinois net loss "shall first be carried to the earliest of the several taxable years for which such loss is allowable and shall then be carried to the next earliest of such several taxable years, etc."

There is no prohibition under Illinois law for carrying net operating loss from an S-corporation year to a C-corporation year, so long as the ordering principles of Rules Section 100.2330(c) are followed. The loss carryback will reduce income in the C-Corporation year for purposes of the Personal Property Tax Replacement Tax as well as for the regular Corporate Income Tax.

Under the circumstances provided, it appears that the taxpayer may carry the net operating loss from the year ending on 12/31/97 back to the C-Corporation year ending on 3/31/95. The actual amount of net operating loss for state purposes for any particular year, of course, may not be the same amount as the federal calculation, so this letter will not necessarily adopt the dollar figures you provide. See Rules Section 100.2320 for the means of determining the Illinois

net loss for any particular year. Form IL-843, enclosed, is used to carry back an Illinois net loss.

As stated above, this is a general information letter which does not constitute a statement of policy that applies, interprets or prescribes the tax laws, and it is not binding on the Department. If you are not under audit and you wish to obtain a binding Private Letter Ruling regarding your factual situation, please submit all of the information set out in items 1 through 8 of the enclosed copy of Section 1200.110(b).

Sincerely,

Kent R. Steinkamp
Staff Attorney -- Income Tax